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THE RULE OF GOOD LAW AND FEDERAL TAXATION

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I

THE STANDARD TO JUSTIFY "CONFIDENCE"

In *McCulloch v. Maryland*,¹ counsel for the state of Maryland, Mr. Hopkinson, framed an argument which has a startlingly modern ring when lifted somewhat from its context. It was addressed to Mr. Webster's point that "An unlimited power to tax involves, necessarily, a power to destroy."² "What," said Mr. Hopkinson, "have we opposed to these doctrines, [those supporting the power of the state to tax the Bank of the United States], so just and reasonable? Distressing inconveniences ingeniously contrived; supposed danger; fearful distrusts; anticipated violence and injustice from the states, and consequent ruin to the bank. A right to tax is a right to destroy, is the whole amount of the argument, however varied by ingenuity or embellished by eloquence. It is said that the states will abuse the power; and its exercise will produce infinite inconvenience and embarrassment to the bank. . . . What power may not be abused; and whom or what shall we trust, if we guard ourselves with this extreme caution? The common and daily intercourse between man and man; all our relations in society, depend upon a reasonable confidence in each other."³

We all remember how Mr. Chief Justice Marshall dealt with this insistence that the national government rely upon "confidence" for its protection against taxation. Also we remember how the Colonies were not content to rely solely upon "confidence" in their

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¹ 17 U.S. (4 Wheat.) 316 (1819).

² Id. at 326.

³ Id. at 347-49.

claims in respect to taxation. Edmund Burke's *Speech on American Taxation*, which emphasized the reliance by Americans on *Principle* in resisting the duty on tea, still touches a responsive chord in our hearts. Our memories, given leave to dance about in history, can recall other rejections of the defense of repose and confidence against taxation: Mr. Joseph H. Choate's argument in *Pollock v. Farmers' Loan and Trust Co.*;⁴ Mrs. Frothingham's unsuccessful fight to give the taxpayer standing to challenge a federal appropriation act,⁵ and Mr. Justice Butler's observation in *Edwards v. The Cuba Railroad Company*⁶ that the Sixteenth Amendment "is to be taken as written, and is not to be extended beyond the meaning clearly indicated by the language used."⁷ All are examples of the desire to erect barriers against the power of taxation of a sort more substantial than mere confidence. There are many others, of course; but, in one sense at least, Mr. Hopkinson's adjuration to the national government has become that of the national government to its citizens and taxpayers. "Judicial ardor," as Professor Lowndes puts it, "for constitutional tilting with federal taxes"⁸ has almost disappeared. A recent guerrilla attack by lower federal courts upon the premium payment test for inclusion of insurance proceeds in the gross estate of the deceased for estate tax purposes was smoothly repulsed by the Supreme Court which pointed out again that the federal taxing power is little hampered by the due process clause or the requirement that direct taxes be apportioned.⁹ There is general acceptance of the notion that there are few, if any, constitutional limitations upon the power of Congress to tax.

This is probably a good thing. Aside from the common contention that the people should have the right to use their government in the way they see fit and the obvious necessity of a strong fiscal arm in times of crisis, the disappearance of substantial constitutional issues is further justified by providing more time and energy to consider what our tax laws should be. When attention is turned in this direction many approaches are available. For example, the teaching and techniques of economics are available to attempt a solution of knotty problems of incidence of the various forms of taxation, the effect of income, estate and gift taxes upon incentives, the degree of market

⁴ 157 U.S. 429 (1895).

⁵ *Massachusetts v. Mellon*, 262 U.S. 447 (1923).

⁶ 268 U.S. 628 (1925).

⁷ *Id.* at 631.

⁸ Lowndes, *Current Constitutional Problems in Federal Taxation*, 4 *Vand. L. Rev.* 469 (1951).

⁹ *United States v. Manufacturers National Bank of Detroit*, 365 U.S. 194 (1960).

distortion caused by tax concessions, limits of taxable capacity and many others.¹⁰ Those interested in the legislative process can investigate the virtues and limitations of such a process.¹¹ Procedure, administrative and judicial, can be closely scrutinized; brave efforts can be made to chart courses of passage safe for the timid, through the turbulent seas of decisions and rulings;¹² and the daring can conceive, execute, and publish the results of perilous voyages which yielded rich cargoes.¹³

And, because tax law is law, jurisprudential speculations would not appear to be out of place. Yet, here is a curious thing. Speculations of this sort are rare.¹⁴ As one reflects upon this, many reasons suggest themselves as explanations. Although taxation, as my colleagues often tell me, is a bore, it has deep emotional roots. These tend to make clear-headed jurisprudential thinking difficult. Also, taxation's intimate relationship to sovereignty and power can make discussion of the nature of law in this context verge on making a brief for civil disobedience.¹⁵ Most of us instinctively feel that if there is a place where a "law is law" approach is necessary and proper, the area of taxation is it. It is better, we appear to think, to conduct

¹⁰ A recently published volume which I find very interesting is "Readings in the Economics of Taxation," American Economic Association (1959). The selections were made by Richard A. Musgrave and Carl S. Shoup. The recent Tax Revision Compendium, House Ways and Means Committee, 86th Cong., 1st Sess. (1959) is, of course, a fruitful source for discussions of this type.

¹¹ E.g., Surrey, *The Congress and the Tax Lobbyist—How Special Tax Provisions Get Enacted*, 70 Harv. L. Rev. 1145 (1957); Ture, *Economics in Taxes: Limitations on the Use of Anti-Recessionary Tax Policy*, 44 Va. L. Rev. 835 (1958).

¹² The shelves of the tax law libraries are fairly groaning under the weight of articles with titles commencing with "How to." Countless similar do-it-yourself pieces are graced with more imaginative titles.

¹³ Quite naturally a minimum of publicity is accorded the most daring of tax exploits. In time, however, the successful ones find their way into the pages of the journals of the tax world. The A B C transaction for financing mineral property acquisitions and the "Amos 'n Andy" and Jack Benny capital gains accomplishments are examples. For an article relating to the realm of our modern aristocracy, the entertainment world, which has some of the aspects of high adventure, see Krage and Barton, *The Tax Dilemma of the Entertainer*, 31 So. Cal. L. Rev. 390 (1958).

¹⁴ Occasionally a writer reveals certain fundamental premises which guide his thinking about tax law. For example, see Lanning, *Some Realities of Tax Reform*, Tax Revision Compendium, House Committee on Ways and Means, 86th Cong., 1st Sess. (1959) Vol. 1, 19. For another article which cuts deeply into certain of the problems encountered in making "good" tax law, see Cary, *Reflections Upon the American Law Institute Tax Project and the Internal Revenue Code: A Plea for a Moratorium and Reappraisal*, 60 Colum. L. Rev. 259 (1960).

¹⁵ An H. Bracken Lee or Eroseana Robinson remind us, however, that some do feel that under certain circumstances tax laws should not be obeyed. Miss Robinson, whose disobedience is bottomed upon pacifism, carried her remonstrance to the point of being imprisoned.

jurisprudential discussions with respect to matters which lie less close to the main-springs of public order. Those with leanings to natural law welcome this avoidance of having to measure their views against the harsh realities of tax law and administration. Positivists are prepared to test their views in more demanding situations.

I suspect this estrangement of taxation and jurisprudence is also fostered by the near maddening complexity of all sophisticated tax structures. It is much better to discuss the issue of whether a hypothetical statute employing the term "vehicle" includes a "baby carriage" than whether the term "securities" in the Internal Revenue Code includes a promissory note payable in five years.¹⁶ And, although this is more doubtful, many probably believe that there is an almost arithmetical precision in the tax laws which makes speculation about the "is" and the "ought" equivalent to an argument about the "oughtness" of the proposition that two plus two equals four.¹⁷ The truth of the matter, however, is that tax law, particularly that which produces large amounts of revenue, raises all the fundamental problems of jurisprudence. The relationship of means to ends, the sources of ends, the meaning and types of justice, the nature and sources of law, the limits of adjudication and administration, the nature of the interpretive process, all exist in the tax law. Of course, this is no great revelation. It does, however, provide the background for a statement of the purpose of this paper.

It would be possible to take any one of the jurisprudential problems just mentioned and explore it, using tax law as the means of study. This I do not intend to do, at least not directly. My approach will be different. The West is committed to the rule of law. In recent years the challenges and taunts of our enemies have led us to think

¹⁶ See H. L. A. Hart, *Positivism and the Separation of Law and Morals*, 71 Harv. L. Rev. 593, 606-15 (1958); Fuller, *Positivism and Fidelity to Law—A Reply To Professor Hart*, 71 Harv. L. Rev. 630, 661-69 (1958), where the meaning of the term "vehicle" is discussed. Jurisprudential speculation similar to that of Hart and Fuller is quite applicable to the term "securities" as it is used in the Internal Revenue Code. Personally I rather doubt that the term has a "hard core" meaning as Professor Hart suggested it would, although some of the earlier cases interpreting it appear to think so. For example, in *Commissioner v. Neustadt's Trust*, 131 F.2d 528 (2d Cir. 1942) the court, after referring to "common financial parlance" said: "A court is justified in believing that when Congress employs in a tax law words having a well defined meaning in the business world, it used them with that meaning in the absence of clear evidence to the contrary." (530). More helpful is the general interpretive approach in Griswold, "Securities" and "Continuity of Interest," 58 Harv. L. Rev. 705 (1945).

¹⁷ This illusion, and a pernicious one it is, is made more prevalent as the tax law becomes more "accountantized." That is, as law makes greater use of fixed percentages and other semi-mathematical formulae the more obscure to the casual observer are the general purposes of the provisions.

much about the meaning of our commitment. This is good, and there is no reason why the implications of this commitment to tax law should not be examined. This is the purpose of this paper. The tax law employed will be that with which I am most familiar—the federal income, estate and gift tax law.

There is one difference between the discussion which follows and the usual discourse upon the rule of law. Most of the latter are concerned with distilling the essence of the rule of law. The search appears to be for the minimum characteristics which will satisfy the commitment. I doubt that this springs from devotion to Platonic idealism. Rather, it appears to me that this tendency arises from mounting doubt about the wisdom and practicability of our commitment. It is difficult to deny that the enemy's presence imposes a strain upon our institutions which produces its full measure of doubt and confusion. However, be this as it may, my concern is not with how bad a tax law can be and still measure up to the minimum demands of the rule of law. Rather, it is with the characteristics which it should possess to substantially conform to "the rule of good law." There are essentially three reasons for this emphasis. The first is to suggest that through our concern with minimum characteristics we are, I believe, unwisely narrowing the scope of our commitment. The second is that by considering "the rule of good law" a greater range of inquiry is possible. While I very much doubt that the content of "the rule of law" is purely formal and procedural,¹⁸ the insertion of the adjective "good" eliminates "arguments at the margin." My last and most important reason is to provide a standard by which we can determine whether the confidence we are admonished to have in the national government's use of "the power to destroy" is justified. A free people are entitled to insist upon such a standard and to withdraw their confidence in that government when there is no substantial compliance. But to remain a free people it is necessary to understand and believe in such a standard. This cannot be over-emphasized. In

¹⁸ Professor Jones in *The Rule of Law and The Welfare State*, 58 Colum. L. Rev. 143, 151 (1958) writes as follows: "Although I, too, think of the concept [the rule of law] as a primarily procedural one, I am by no means sure that a meaningful rule of law has nothing whatever to say concerning the substantive content of legally enforced principles." I rather think Professor Jones was more restrained than he need have been. The rule of law is for something. Its structure should be shaped by its purposes. I should think the content of rules emerging from a society purportedly living under a rule of law will affect the viability of the procedural aspects of the rule of law. Can a judge long adhere to the standard "good faith" and "high seriousness," which Professor Jones regards as an essential aspect of the rule of law, when required to apply "wicked" laws? I think not. Cf. Fuller, *Positivism and Fidelity to Law—Reply to Professor Hart*, 71 Harv. L. Rev. 630, 644-46 (1958).

our society, too much afflicted with rule by massive, ponderous blocs, and threatened as it is from all sides, such belief and understanding are difficult to preserve and foster. No discussion of this standard can be entirely superfluous at this point in our history.

II

THE NATURE OF THE RULE OF GOOD LAW

Lord Macmillan once said, in a discussion of what he called "the reign of law," that "The essence of the law resides in its conformity with the conscience of humanity."¹⁹ This also describes good law. Put somewhat differently, the sovereignty of good law depends upon substantial agreement by the members of a society with the fundamental means and ends of their society. This, standing alone, says very little, and could mean that the rule of good law merely reflects society's, to use Santayana's words, "idle escape from one error into another."²⁰ For its meaning to escape the trap of complete relativism, it is necessary to posit some important and enduring characteristics of man. If such exist and are correctly stated, it is then possible to comprehend "the conscience of humanity" and to understand which means and ends are likely to enjoy the acquiescence and support of the members of a society. I believe this can be done.

To say this involves a commitment, and a dangerous one at that—a commitment because it removes one from the role of the curious but detached observer of the affairs of men, and dangerous because the part of the false prophet is the not unlikely alternative.²¹ We who teach, however, can hardly avoid a commitment of some sort, nor should we try to do so. This impelling force of our profession is what makes our lives the dangerous but glorious adventures which they are.

To me, man is the product of tensions caused by the antinomies of his nature. Tensions created by internal contradictions are his fate. His capacity for knowledge and wisdom is limited. In this sense, at least, he is under God. Thus there can be no definitive compilation

¹⁹ Macmillan, *The Reign of Law: Western Europe Strives to Re-establish It*, 35 A.B.A.J. 27 (1949).

²⁰ Santayana, *The Realm of Essence* 5 (1928).

²¹ We know of many such prophets and their follies always tempt us to seek the shelter of passive acceptance of the prevailing mores. We also know of many whose views appear amazingly durable, and this encourages us to commitment. I believe Professor Wechsler spoke truth when he observed that we are "united in belief in norms of right and justice that transcend positive law, yielding criteria—broad as they are—by which all government and law may properly be judged." *Government Under Law*, Harvard Symposium 131 (1956).

of the antinomies of his nature. Although he realizes this, he repeatedly attempts the impossible task of understanding himself completely. His failure is not total, however. Certain predispositions which constitute some of the conflicting forces can be isolated. Let me illustrate. Man is predisposed to love; but he is also predisposed to hate. Both are natural tendencies or propensities. He is inclined to be generous in giving aid to others; but he is also selfish and acquisitive. He is social and gregarious; but he also seeks solitude and apartness. He believes in equality; but he also strives for inequality. He is predisposed to worship the portions of his environment which are beyond his power and understanding; but he strives to reduce the magnitude of the object of his veneration by enlarging his power and understanding. He is predisposed to contentment when he understands the reason and purpose of the institutions which surround him; but faith can bring serenity to him. He tends to aspire to rule other men; but he also tends to prefer to be ruled by strong men. He admires objectivity and finds it often accompanies dependence on no single course; but he also admires partisanship and finds it often accompanies a commitment of all to a single source. He worships both Dionysus and Apollo. He aspires to be individually responsible for his destiny; but he also petitions the group for aid in the attainment of his ends. And, of course, he loves war as well as peace.

These and other antithetical characteristics shape man's institutions and the best and most durable of them are those which permit temperate expression of such traits and predispositions. Even the individual suffers when he attempts to lock within himself too many of these tendencies. He is too much "inner-directed." He becomes, we say, "warped" and maladjusted. This somewhat Hegelian approach to the "conscience of humanity" should not be understood to carry with it a commitment to some form of ultimate synthesis of reason, nor should it be taken to assert that the balance of these antinomies is the same in every society. The former is not necessary to the purpose at hand, and the latter is contrary to common observation. Some men hate more than they love, seek society more than solitude, and give faith ascendancy over understanding. The converse is true of others. So it is with groups of men. Yet in all exists the power of the negative and disaster follows those who blindly ignore it.

There are a number of consequences of importance in understanding the "conscience of humanity" which flow from this view of the nature of man. The first which I wish to mention is that the aim of social and political activity should be to design a structure in

which the human predispositions can, through expression, check or complement one another so as to assure a temperate, moderate and tolerable expression of all. For example, the propensity to hate can be turned on those who love war too well. The inclination to war can be used to provide the civil order and security which is needed. The desire for inequality can provide the initiative and leadership necessary for society. The necessity to love can, as perhaps Orwell pointed out, check the will to rule. The compulsion to worship can ameliorate selfishness and greed. The examples can be multiplied, but the point is clear. Virtues and vices have their function; that is, to produce a moderate expression of the attributes of human nature. In religious terms the problem concerns the role of sin. God, in Martin Luther's words, says to the Devil, "Devil thou art a murderer and a criminal, but I will use thee for whatsoever I will. Thou shall be the dung with which I will fertilize my lovely vineyard. I will and can use thee in my work on my vines. . . ." ²² My first consequence can not be put more beautifully.

A second consequence, of equal importance with the first, is that the employment of means to accomplish one or more of man's aspirations will generate circumstances which tend to prevent the attainment of others. This usually unintended frustration of the latter increases in severity as the yearning for the former intensifies and as more and more devices are mobilized for its realization. Another way of putting this is to say that the more completely we seek a certain end the greater the price we must pay in the form of forsaking other ends. As a result the single-minded, highly-concentrated drive toward a single, fairly concrete objective will be rewarded with an unexpected amalgam of success and failure. This is the source of much of human tragedy, and the operation of this grim law never fails to stir us with bitterness and anguish. "Why is the good so elusive?" we wail, forgetting that the answer lies within our own being. This consequence, the fact that a defeat always accompanies a victory, should operate as a restraint upon too intense pursuit of somewhat narrow, rationally enunciated, purposes. Such pursuit confuses what we think we want with what we do, in fact, want, *viz.*, the more or less balanced and moderate expression of our antithetical selves.

Third, it follows that there is no perfect solution to our problems because the manners in which this balance can be struck are multitudinous, if not infinite. Frank Knight recently put the point this way: "The Good means the better; there is no such thing as a

²² Quoted by Herman Obendiek, *Der Tüfel bei Martin Luther*.

meaningful ideal of perfection."²³ Our striving for, joined with the unattainability of, perfection is itself a source of great tension. Only the wise do not despair when it is realized that the true ends are never attained but only approached.

Fourth, it is obvious that there will be endless experimentation by man in his effort to create the institutions which will afford the most satisfactory expression of himself. He is doomed to "ever becoming," but never "to become." It does not follow, however, that any change is as good as another. The criterion for judgement is the extent to which the experimentation gives fair promise to bring about a better environment for the moderate expression of man's antithetical being. There is much room for difference of opinion when a proposed change is measured against this criterion, and this leads to the fifth consequence of my view of the nature of man.

It is that tolerance of these differences of opinion is imperative to prevent a strait-jacketing of society which is so contrary to man's nature that it will produce its opposite reaction of violence and disorder. Yet, to me at least, this necessity of tolerance does not require acquiescence to the demands of those who unqualifiedly deny what I am describing as the nature of man. To acquiesce would constitute a denial of my basic premises and make me untrue to myself. Those who, in the name of tolerance, ask me to do this ask for too much. To these demands I am obligated to be intolerant. This is a mantle of responsibility which accompanies commitment. As stated earlier, the possibility of error is ever present; but life demands risks.

Assuming some of the fundamental characteristics of man have been described with a fair degree of accuracy, and that the aforementioned consequences are correctly deduced therefrom, I believe there emerges a basis for substantial agreement about the content of the rule of good law. There are, of course, a number of ways in which this can be described. My preference is to state three purposes which should be served by the legal, political and social structure of any good society. The first of these is to afford the protection, only in the last analysis supplied by arms, from those bent on destruction necessary to permit the essential work of life to be done. The brigand and the barbarian must be held in check. The second is to provide and maintain the climate favorable for purposeful thought and discussion and the ability to act upon its basis. All need not be permitted to share in this process; but it is equally clear that a "favorable climate" is inconsistent with all such thought and action being

²³ Knight, *Intelligence and Democratic Action* 131 (1960).

the result of the will of one. Some substantial interchange of views and sharing of decisions and actions is essential.

Finally, the institutions of a good society ought to create the conditions which afford the balance of what Lewis Mumford has called "the processes of individuation and socialization"²⁴ which is in keeping with the benign balance of the contradictions of human nature, generally favored by the group. Freedom and subjugation, status and contract, *Gemeinschaft* and *Gesellschaft*,²⁵ liberty and security, apartness and togetherness, all must be mixed in a manner which fully recognizes the tension of life and roughly corresponds to that desired by the group. Put another way, the chains in which Rousseau always found man can be lengthened and made lighter; but they can never be removed, nor should we try to do so. Their removal produces alienation and perhaps anarchy; but a completely shackled society stunts its own growth as well as that of its members. The dual standard—conformity to the nature of man *and* his desires—is necessary because the proper balance, as stated before, can be achieved through many different combinations of institutions.

Many of our modern problems, if an aside be permitted, appear to stem from a rejection, at least in part, of the nature of man as a standard and too warm an embrace of our desires as the sole measure of goodness. Modern man, as Reinhold Niebuhr has pointed out, tends to find security and ultimate meaning in the "supposedly increasing values of human cooperation,"²⁶ but the danger encountered by this approach is the trituration of society and the destruction of the "process of individuation." We are attempting to sculpt our society without viewing from all sides our model—man and his nature. While it is true that modern man feels the icy-fingered clutch of estrangement from his surroundings, our compensatory pursuit of a kind of collective hedonism has led us to ignore many of the contradictions and conflicts within the nature of man and to romanticize our accomplishments beyond all reason. The corrective of a more critical attitude toward ourselves and, perhaps, a good measure of pessimism is long overdue. Fortunately, there are promising signs of their emergence. Our immediate problem, however, is how well our existing federal income, estate and gift taxes conform to the three purposes which should be served by our legal, political and social structure.

²⁴ Mumford, *The Human Prospect* 184 (1955).

²⁵ The reference is to the title of a book by Ferdinand Tönnies. It has been translated by C. P. Loomis. See *Community & Association (Gemeinschaft and Gesellschaft)* (1955).

²⁶ Niebuhr, *An Interpretation of Christian Ethics* 16 (1958).

Before turning to this measurement, a fundamental question affecting the validity of the structure of my analysis must be dealt with. The question is this. Assuming the three purposes served by the rule of good law provide satisfactory criteria for judging society as a whole, do they have any particular utility to the task of determining the goodness of a particular body of law, or human institution, such as federal taxation? A negative answer is suggested when one attempts to relate the almost trivial character of a single legal rule to the nearly cosmic nature of the three purposes served by the rule of good law. How, for example, can it be determined by using this sort of grand measuring device whether the rule is a good one which makes acceptance effective upon dispatch of a properly posted assent? Obviously the calipers I am suggesting here are not made for measuring the goodness of such a rule. Yet they can be made to do such unnatural work. Is it not true that the rule making acceptance effective upon dispatch, together with the cognate rule making revocation of the offer effective upon receipt, is justified by the encouragement it provides the offeree to rely upon the promise at a time earlier than certain other rules would permit? If this is so, why should we encourage this reliance? Is it to strengthen the legal and economic institution of contract? If so, why should this be done? Is it because this institution is a source of order which serves some of the purposes of the rule of good law? If so, which ones? Thus, with a somewhat labored effort can the calipers measure to some extent the merit of a single rule.

This demonstration, however, does not entirely meet the point of the question, because it suggests that the institution of contract does not, and cannot, fully serve all the purposes of the rule of good law. It cannot, for example, provide the status which is necessary in a good society. It must play its part in the rule of good law but it is not the entire cast. How then is federal taxation different? Does it not also play only one role among many? The answer must be a qualified one. Its function and scope are limited; but its structure reveals many of the dominant features of our society. This comes about because the heavy revenue burden supported by the tax structure in recent years has served to impress upon it the outlines of our society and, in turn, the shape of the tax structure has left its mark upon our society. Thus, there is an interaction between our social and tax structures which justifies the use of calipers grand enough to measure our entire society. It is true, as I shall point out in closing, that it would be wise to maintain, and perhaps further restrict, the limited function and scope of these taxes; but in our time the

revenue demands will never sufficiently abate to eliminate the fairly extensive interaction which is the justification for my approach. It is to life, not death, that taxes are more closely related.

III

THE EXTENT OF CONFORMITY OF FEDERAL TAXATION TO THE RULE OF GOOD LAW

The approach which reflection has led me to adopt to illustrate the degree to which the present federal tax structure conforms to the rule of good law is one which should have been immediately obvious. It is first to demonstrate the characteristics of this structure which suggest conformity, and then those which do not. This will highlight an important feature of this structure, i.e., that it does not, in many significant respects, probably increasing in number, conform to the rule of good law. In view of what has been said about the relationship between the tax structure and society it should not be surprising or particularly alarming that the federal tax structure should embody some not-so-good and bad law. It is disturbing, however, to observe that the quantity of this type of law appears to be growing. The predominant motion of the federal tax law, in my opinion, is in the wrong direction and this is a matter for serious concern.

But first the real and significant contributions to the rule of good law made by the federal tax system should be set forth. Its contribution to protection from the incursions of those who threaten to disturb the peace is obvious. The net receipts from all sources for the fiscal year 1959 was sixty-eight billion.²⁷ Expenditures for major national security in this period were something over forty-six billion.²⁸ The aggregate sum expended for this purpose in fiscal year 1960 declined very slightly.²⁹ Since the receipts in the fiscal year of 1959 from the three taxes with which we are concerned (income, estate and gift) were over fifty-five billion,³⁰ it is apparent that their contribution to the preservation of order was enormous. The income tax, particularly, produces an enormous volume of revenue and serves this cause admirably.³¹ These evident truths cannot be restated too frequently.

²⁷ Annual Report of the Secretary of the Treasury for the Fiscal Year Ended June 30, 1959, 372.

²⁸ *Id.* at 15.

²⁹ Surrey and Warren, *Federal Income Taxation* 36 (1960).

³⁰ Annual Report of the Secretary of the Treasury for the Fiscal Year Ended June 30, 1959, 7-9.

³¹ In fiscal year 1960 the individual income tax was estimated to produce a net yield of \$40.3 billion. The estimated yield of the corporation income tax was \$22.2 billion. Surrey and Warren, *op. cit.* *supra* note 29.

However, it is certainly theoretically possible to conceive of the same, or greater, volume of revenue being produced by a tax resembling a sales tax and this, in turn, requires the question whether these three taxes conform to the rule of good law in a way in which a sales tax would not. It is conventional wisdom, to borrow a term from Galbraith, to think that they do; and in this instance conventional wisdom probably speaks truthfully. Three features, one of which is applicable only to the income tax, lead me to this view. These are the progression of rates, the self-assessment system, and the withholding procedure.

Progression contributes substantially to the rule of good law in a manner in which the sales tax could not. This comes about because of the major purpose served by progression, *viz.*, the reduction of inequality. Blum and Kalven have demonstrated to my satisfaction that this is the most persuasive justification for progression which exists.³² Other theories, such as the greater benefit, equal or minimum sacrifice on the assumption of some decline in the utility of money, ability to pay, and the nature of compensatory economics, do not so adequately establish the firm foundation which progression requires.³³ The first means by which progression reduces inequality is obvious. It takes progressively more money from the rich than it does from the poor. The decline in the percentage of disposable income in the hands of the rich in recent years³⁴ indicates that it has had some effect even though it would be improper to conclude that the entire decline is attributable to progression. Other forces have also been at work, such as the still growing control of the labor market by labor organizations, the professionalization of management and its partial severance from the families whose ancestors founded the enterprises, the public's distaste for "large" profits being reaped by "established" corporations, the power of the farmer and other reasonably large "needy" groups, and the outpouring of funds to other nations hopefully designed to serve the dual interests of humanity and national survival. The opinion that the rich should not be coddled by government is a view held by most and its implementation takes many forms. Only in the newer parts of the nation are the rich clothed with some of the tattered fragments of the mantle of legitimacy which it was once their proud honor to wear.

Progression serves the interest of less inequality in another and more subtle way. It is widely recognized by those more than casually

³² Blum and Kalven, *The Uneasy Case for Progressive Taxation* (1953).

³³ *Ibid.*

³⁴ Galbraith, *The Affluent Society* 85-87 (1958).

acquainted with our tax structure that the rate tables in the Code bear little resemblance to the actual rate of progression at which income, particularly, is taxed.³⁵ However, I suspect that this fact is not widely known³⁶ and that this ignorance, joined with the knowledge that an income tax exists about which the rich are constantly complaining, leads many to the satisfying conclusion that the rich are bearing a greater burden than they do. This illusion brings repose and, as will be made clear in a moment, serves some of the same purposes which would be served by reality.

To understand how this illusion may, in fact, serve the same ends as would reality, it is necessary to examine how the reduction of inequality tends to conform to the purposes of the rule of good law. To do this adequately a few observations about the nature of the appeal of lessened inequality will be helpful.³⁷ As should be expected, the sources of such an appeal are both noble and ignoble. Envy and covetousness generate a substantial portion of this attraction; but it is also true, as Jerome Hall³⁸ and others have pointed out, that equality is a major portion of the democratic ideal. Indeed, it does not widely miss the mark to say that in democracy the tendency is to make the guide "to each equally" the general rule and impose a fairly heavy burden of proof upon those seeking to create or legitimate a variant. This burden, however, is always lightened to some extent by our somewhat contradictory commitment to another democratic ideal—liberty.³⁹ The synthesis of these ideals is the day to day work of a democratic regime. DeTocqueville long ago traced with brilliant prescience many of the means by which the democratic ideal of equality would be worked pure in our society.

³⁵ Many authorities have made this point. For a recent and terse restatement of the point see Surrey, *The Federal Income Tax Base for Individuals*, in *Tax Revision Compendium*, House Committee on Ways and Means, 86th Cong., 1st Sess. (1959) Vol. 1, 1.

³⁶ My feeling is based primarily on the absence of public concern about the matter. While the new Administration may move against selected targets in the tax law, there appears presently little pressure for the comprehensive revision which would be necessary to make the rates realistic. One investigation indicates that people tend to approve the status quo in distributing the tax burden whatever that happens to be. Blum, *Some Off-Center Observations About Our Tax System*, N.Y.U. 16th Tax Inst. 1, 4 (1958).

³⁷ In Blum, *supra* note 36, it is indicated that most people do not think of progression as a contributor to a redistribution of income but rather base their approval on an ability-to-pay slogan. While this may be true, just as it is true that there has been a decline in interest in equalitarianism as a political goal, I seriously doubt that the appeal of lessened inequality has vanished. To some extent it is passive, and to some extent it is spending itself in the area of civil rights, but its presence I do not doubt.

³⁸ *Living Law of Democratic Society* 98, 99 (1949).

³⁹ See Friedman, *Law in a Changing Society* 491 (1959).

An aspect of the democratic ideal of equality which, I believe, throws additional light upon the appeal of lessened inequality is that in the minds of many the ideal of equality serves to hold in check "the human tendency to evil"⁴⁰ that would too abundantly flourish in its absence. In more politically oriented terms, lessened inequality tends to assure a more extensive dispersion of power and to minimize the opportunity for massive misrule.

There is another source of the appeal of lessened inequality which is in truth a legacy of Marx. The logic of the capitalist structure was to Marx inconsistent with its survival. The seizure by the bourgeoisie of the surplus value created by labor would in time destroy the system through revolution. To those not prepared to fully accept this apocalyptic version of history, but nonetheless impressed, as one properly may be, with Marx's emphasis upon the importance to social institutions of the manner in which production is organized and with the grandeur of his synthesis, some redistribution of income, perhaps, would seem to avert the disaster he foretold. However, those who view the reduction of inequality as a tribute to be paid to the ghost of Marx are always acutely aware, as Galbraith has put it,⁴¹ of the whisper of the Marxists that it is not enough. The intensity and persistence of this whisper lead many to see in progression a symbol of the means of capitalism's escape from the grim jaws of Marxian disaster and never to be satisfied quite completely with a rate structure which can be increased.

The ghost of Marx, however, is not the only shade to strengthen the appeal of diminished inequality. Another is Keynes. His macro-economic views, which altered substantially the previously assumed roles of savings and consumption in the economy, clearly suggest not only a means of narrowing the gap between the rich and the poor, by moving funds from idle stocks of money to sectors of the economy where a high propensity to consume exists, but also a means by which all can move to a higher but more flat plateau of plenty. So viewed, resistance to the diminution of inequality is equivalent to the attitude of the dog in the manger.

An often neglected source of the appeal of reduced inequality is simply that it approaches the ideal of equality which, in turn, rests some measure of its appeal on its apparent simplicity. How often in searching for criteria by which to apportion the goods and perquisites

⁴⁰ See a very interesting statement of what might be called "fundamental liberalism" in Adams, *The Liberal View of Man and Society*, 11 *The Carolina Quarterly* 30 (1958).

⁴¹ Galbraith, *supra* note 34, at 82.

which come within our control as individuals do we solve our problem by an equal division! And this is done even though we recognize the possibility of having perpetuated inequality by awarding equal shares to unequals. The equality of shares, however, carries with it a presumption of fairness, one might say, which makes criticism appear churlish and mean. This is a truth of which administrators, legislators, estate planners and parents have long been aware. So it is that "to each equally" draws support because of its simplicity, albeit this is somewhat specious, and, in turn, furnishes persuasive force for the reduction of inequality.

And, finally, Christianity has encouraged the belief that differences in the station in life between people are transitory things and that all are equal before God. Not unnaturally such views operate as a deep reservoir of conviction from which flow designs whereby God's promise can be redeemed on earth. Michael Polanyi recently has set forth very clearly how the tension between Christian precepts and existing society can generate an intensely fanatical desire to sweep away existing injustices and even lead to the establishment of "moral supermen" who acknowledge no moral restraints whatsoever.⁴² Even when passions do not reach this pitch, the steady tug of Christian beliefs produces a preference for reduced inequality.

These, then, are at least some of the sources of the appeal for lessened inequality. It now should be clear how such shrinkage of the area between the rich and the poor tends to consistency with the purposes of the rule of good law. The interest of civil order, for example, is served by giving controlled expression to covetousness and envy. To the extent that some are lifted by the process of shrinkage there comes into being an opportunity for their greater participation in the formulation of decisions and in the actions which ensue. There is, it is believed, a greater sharing of many of "the things that count." In addition, a device such as progression directed to reducing inequality gives some modest assurance to the poor that they have not been forgotten and, although this can hardly induce an attitude of serenity comparable to that of the fowls of the air or the lilies of the field, it does furnish some security and sense of belonging which must exist in a substantial measure in every healthy society. I do not wish to over-emphasize this aspect of progression, however, because its contribution is, at best, cold, impersonal and somewhat capricious. On the other hand, progression, so long as its rates do not equal 100%, does permit some reward to the rich and

⁴² Beyond Nihilism, 14 Encounter 35 (1960).

thus leaves intact some inducement to the individual to better his economic position. In short, progression itself reflects an effort to balance, to return to Mumford's phrase, "the processes of individuation and socialization." Finally, the contribution which the illusion mentioned earlier, respecting the burden carried by the rich, makes to the purposes of the rule of good law is simply that it assuages the envy and fosters the sense of security of those who share it.⁴³

The second feature of the federal taxes with which we are concerned which demonstrates the superiority of their conformity to the rule of good law over that of sales taxes is, as noted, the self-assessment system. This superiority flows from the opportunity it provides for extensive participation in what is essentially a governmental act. This participation substantially contributes to the creation and maintenance of an atmosphere favorable to productive thought and discussion about both the sources of governmental revenue and the nature of its expenditures. A sales tax, exacting its toll amidst the bustle and haste of the market place and, as often as not, partially concealed from the immediate bearer of its burden, cannot make such a contribution. It is ancient republican dogma that the best government is one in which the governors and the governed frequently exchange their positions.⁴⁴ To a significant extent the self-assessment system makes this possible.

This sharing of governmental responsibility under these tax laws, involving as it does countless man-hours of thought, computation and instruction, brings to the awareness of many the fundamental truth that democracy requires responsible citizens. What better exercise to understand the full force of Kant's categorical imperative can there be than when one weighs the merits of excluding an item of income or claiming a deduction which is not proper but which is not too likely to be caught by any possible audit? Even when the decision goes against the government, which means against our fellow citizens, we are aware of our departure from a high ethical standard and proceed to find our solace in the baser norm of conformity to what we have reason to believe is the general conduct of others similarly situated. I suspect more persons dimly perceive, at least, that this

⁴³ Recognition of the occasional beneficence of illusions should not obscure the cost their use entails. See p. 232 *infra*. However, no society can dispel all its illusions, even assuming that the epistemological problem of what constitutes an illusion is resolved.

⁴⁴ George Sabine points out how this "device of statecraft" was considered extremely important in the republicanism of both Machiavelli and Harrington. *A History of Political Theory* 347, 504 (rev. ed. 1951).

norm cannot assure responsible citizenship because it condones conformity to irresponsibility. Thus, we frequently are made aware that, to use a term badly overworked and carrying a gloss of scientism which tends to obscure its human and personal aspects, the democratic process must be more than an ever-shifting complex of compromises between individuals, groups and factions each predominantly bent on imposing its selfishly-oriented will on the other. This is training in citizenship of a fairly high order, equal in value, if not superior, to the exercise of the franchise.

It may appear inconsistent with what has been said to assert now that the withholding procedure under the income tax law also conforms to the criterion of the rule of good law to a significant extent. And to a large extent this appearance is real. It does eliminate, or at best dilute, the training in citizenship which self-assessment imposes. More about this will be said later. There is, however, another side to withholding which upholds the rule of good law. I do not refer to the fact that it assures the volume of revenue desired because this would not distinguish it from a sales tax. Rather, the thought is that by shifting at least a portion of the assessing and remittance burden from the individual employee to his employer a small bit is contributed to the development of a sense of community between them. To a certain extent one cannot escape a feeling of "belonging" when the eye travels over the voucher which often accompanies the pay check and notes the provisions for the present and future that are being made for him through the employer. "Belonging," of course, can be turned easily into dependence and subservience, but employer indifference to the welfare of the employee does increase the sense of alienation which is so prevalent in our time.

To sum up, the income, estate and gift taxes conform to the rule of good law because of their revenue producing capacity. In addition, they possess three characteristics (progression, self-assessment and withholding) which make them superior to a sales tax producing the equivalent amount of revenue. These three taxes, however, are in accord with our criterion of the rule of good law in another way which should not be presented in contrast to the sales tax. The third purpose to be served by good law—to balance the interests of the individual and the group—achieves its end, it will be recalled, by satisfying the dual standard of the nature of man and his desires. I believe these taxes substantially correspond to our desires about the proper balance between the two. This view is justified by observing how the structure of these taxes mirrors some prominent features of our social and economic life.

Let me develop this point. In the first place the taxes are designed for a money economy in which the market plays a paramount role, and our economy tends in this direction. The imputed income problem, perhaps best brought to focus by the dextrous do-it-yourself taxpayer who builds or repairs his own home or the hardy self-reliant farmer who produces a substantial part of what he consumes, illustrates that a society becomes more suitable for the income tax as it moves from status, in which the attributes of such are seldom a matter of bargain and sale, to contract, in which there is marked division of labor and the goods and services required by life are purchased from specialists. Although perhaps inherently less so, the estate and gift tax are similarly dependent upon a money-exchange economy because their base is computed by using "fair market values."

Another way in which the income tax, particularly, matches the social fabric we and our forebears have woven is that it is a tax only suitable for a people who closely calculate their economic position and keep detailed records. Schumpeter has drawn our attention to the fact that double entry bookkeeping is a "towering monument" to the rationalism of "capitalist practice."⁴⁵ A highly developed system of accounting is also a necessary technical precursor to the income tax. The mind and will of a calculating, record-keeping people is what Ferdinand Tönnies described as *Kurwille*⁴⁶—a cautious mentality which prudently weighs the advantages and disadvantages of the available courses of action. Such a people are inclined toward a balance between status and contract which tends to favor the latter. Hence, we, as such a people, have selected a means of levying and collecting taxes which fits our notions of the proper balance, and in so doing have served the interests of the rule of good law.

Indeed our tax system has accentuated our inclination toward the type of rational mentality which functions best in capitalism. The tax factor in all family and business arrangements introduces an element which calls for mathematical evaluation of a multitude of eventualities. For example, in estate planning what is the effect of a family death in advance of the period of life expectancy upon aggregate death duties?⁴⁷ Or, again in estate planning, what portion

⁴⁵ Schumpeter, *Capitalism, Socialism, and Democracy* 123 (3d ed. 1950).

⁴⁶ See note 25 *supra*.

⁴⁷ Premature death may lessen the amount of death taxes, as where the husband dies prior to reaching his full wealth producing capacity, or it may increase them, as where the wife who survives her husband fails to reach her expectancy and thus leaves unconsumed a portion of the husband's estate which it had been thought would be necessary for her maintenance. Many assumptions, such as earning capacity of the assets in the estate, the standard of living of the person involved, the probable level

of the marital deduction will achieve the greatest tax saving under various assumptions as to the time of death of the spouse and children?⁴⁸ Or, what is the effect on death duties of property held jointly as compared to that held by tenancy in common?⁴⁹ The tax factor also gives what can be called an added dimension to many business transactions which transforms what would be losses according to ordinary commercial calculations into gains. This enhances the sporting element which to some extent colors the conduct of business affairs. It requires a fairly high degree of commercial sophistication to grasp the fact that the tax factor can make the gift of property a profitable venture,⁵⁰ the exchange of entrepreneurial status for that

of taxes during the ensuing decade or so, and the general level of business and government activity, are employed in the calculation of the effect of premature death on death duties. The point is that the tax system creates a pressure to engage in close calculation of the consequences of a number of eventualities. It would make an interesting study to examine many estate plans after their main objects have been either served or frustrated to determine the general level of accuracy of the many assumptions which went into their formulation.

⁴⁸ The starting point in planning the use of the marital deduction, a deduction roughly equal to one half of the estate of a decedent spouse after deductions for certain debts and expenses, is to employ it in a manner which will result in the division of the aggregate estate of the spouses into two equal parts with the estate tax imposed on each part separately. Generally this will produce the minimum effective rate of tax on the aggregate estate. To achieve this equal division it will be necessary for the spouse with the larger estate to employ less than the full marital deduction because the maximum deduction would make the estate of the surviving spouse larger than that of the decedent spouse. This may not be wise, however, if the surviving spouse is expected to live for a substantial period of time. Under such circumstances there may be the opportunity for disposing of the assets, received from the decedent spouse by way of a bequest which qualified for the marital deduction, by means of gifts to the children which will escape tax or be taxed at the lower gift tax rate. Some nice calculations combining the exact science of mathematics and the not-so-exact science of medicine become necessary.

⁴⁹ Many complex tax questions arise from the use of joint tenancies and tenancies by the entirety. The one referred to in the text involves the marital deduction. See note 48 *supra*. Where the spouses own property in equal shares as tenants in common, upon the death of one spouse survived by the other it is possible for three fourths of the total value of the property to be relieved of death duties at that time. On the other hand, upon the death of one spouse survived by the other only one half of jointly held property acquired with consideration furnished solely by the decedent spouse will escape such death duties. This advantage of the tenancy in common possibly is reduced by the fact that jointly held property may acquire a "stepped-up" basis for income tax purposes. Int. Rev. Code of 1954, § 1014(b)(9). See generally Rudick, *Federal Tax Problems Relating to Property Owned in Joint Tenancy and Tenancy by the Entirety*, 4 *Tax. L. Rev.* 3 (1948).

⁵⁰ For some tables computed under the Revenue Act of 1951 which illustrate the "in-pocket" gain from a charitable gift of property which has appreciated in value by taxpayers subject to certain marginal rates, see Seidman, *Save By Giving*, 30 *Taxes* 338 (1952). The formula for determining when a donor is better off by giving the property away to charity than by selling the property and keeping the proceeds after taxes is set forth in Griswold, *Federal Taxation* 429 (5th ed. 1960). It is as follows:

of a salaried consultant the producer of profit and philanthropy simultaneously,⁵¹ the creation of rather functionless corporations joined with carefully drawn conveyances of mineral property an often profitable substitute for a mortgage,⁵² and the investment of borrowed funds in certain assets, ranging from bonds to bovines, and their sale at an apparent loss, produce a profit.⁵³ Truly it can be said that the Cash McCalls are direct descendants of the Forsytes.

$$\text{The Value of the property must exceed Basis} \times \frac{\text{Donor's top tax rate}}{\text{Minus .75}}$$

(The formula assumes a maximum capital gains tax rate of 25%.)

For additional tables more recent than those of Seidman's, see Penick, *Tax Economics of Charitable Giving*, 38 *Taxes* 111 (1960).

⁵¹ The type of transaction referred to takes several forms. However, the general pattern is for the owner of a business to sell to an exempt organization with payment to be made over a period of time from the income of the business. The operation of the business may be through a "feeder corporation" or under some lease arrangement which will avoid the pitfalls of the Code's provisions taxing the unrelated business income of certain exempt organizations. Int. Rev. Code of 1954, §§ 511-15. The seller will serve as a manager of, or consultant for, the business so transferred. The tide of the decisions appears to be running in favor of such devices when carefully designed. See *Ohio Furnace Co.*, 25 T.C. 179 (1955). Compare *A. Shifman*, 32 T.C. 1073 (1959)(A). But see *Kolkey*, 27 T.C. 37 (1956), aff'd, 254 F.2d 51 (7th Cir. 1958). The Revenue Service views this sort of device with some skepticism. Rev. Rul. 54-420, 1954-2 C.B. 128. For general discussions see Grant, *Taxation of Exempt Charitable Organizations Engaging in Business Activities*, 4 U.C.L.A.L. Rev. 352 (1957); MacCracken, *Selling a Business to a Charitable Foundation*, U. So. Cal. 1954 Tax. Inst. 205.

⁵² The reference is to a transaction known to the mineral industry as the "A B C deal." A vendor of producing mineral property conveys the property to a corporation formed to assist the financing of the purchase of the property by the vendee. This corporation pays the vendor the full purchase price from funds borrowed from a bank for that purpose. The property is then transferred to the vendee with the corporate transferor reserving a production payment roughly equal to the deferred payments plus interest which the vendee has agreed to make. The down payment is made by the vendee to the corporate transferor and the amount of the loan by the bank is reduced by that amount. The same result can be reached more directly by means of a transfer of the property by the vendor directly to the vendee with the appropriate production payment reserved which is then sold by the vendor to the corporation assisting the financing. The holding of the production payment by the corporation, the "C" in the "A B C" designation, which entitles it to a certain share of mineral production, serves the function of a device to secure repayment of the funds used to satisfy the purchase price paid the vendor. For a comparison of the "A B C deal" with a straight purchase secured by a mortgage see *Wilkinson*, *A B C—From A to Z*, 38 *Tex. L. Rev.* 673 (1960). See also Appleman, *The A B C Deal*, 11 *Institute on Oil and Gas Law and Taxation* 519 (1960).

⁵³ The essence of these devices is to borrow funds to finance the acquisition of certain assets, obtain a tax deduction for the interest payments required by the loan, and have the profit of the transaction be taxed at capital gains rates or escape tax completely. Thus, dollars costing 20¢ after taxes, for example, can yield a return of 75¢ after taxes. With such a spread the return of fewer dollars than sent forth may still leave a comfortable profit. Both cattle, which is breeding stock, and securities

Our system of bargain and exchange guided by rational and more or less informed self interest is mirrored in our tax structure in other ways. One of these, although some will certainly disagree with my way of presenting this aspect, is that it extends benefits in exchange for fairly specific prices to be paid by the taxpayers. For example, everyone who has engaged in tax planning which has as its end the multiplication of taxpayers to shorten the reach of progression recognizes full well the importance of drilling the client on the things which he must do to gain this benefit. In using multiple corporations, to take one instance, the price of maintaining precise records, observing corporate formalities meticulously, employing separate personnel, and incurring some commercial risk distinguishable from that of the related corporations are presented to the client as a part of the price he must pay.⁵⁴ This cost is then measured against the "return" from

have been employed as the vehicle for playing the spread caused by the difference between ordinary income and capital gains rates. In recent months a number of cases involving securities, as well as certain annuity contracts, have been before the courts. E.g., *Goodstein v. Com'r*, 267 F.2d 127 (1st Cir. 1959) (interest payments to finance acquisition of government securities not deductible); *Lynch v. Com'r*, 273 F.2d 867 (2d Cir. 1959) (interest payments not deductible because transaction did not create a debt). The taxpayer won a victory in the Tax Court. See *Lee Stanton v. Com'r*, 34 T.C. — No. 1 (1960) (interest deductible where taxpayer had some expectation of a profit aside from that produced through the operation of the tax laws). The Supreme Court has acted in the single premium annuity bond cases, *Knetsch v. United States*, 364 U.S. 361 (1960), resolving a conflict between the Fifth Circuit's view appearing in *United States v. Bond*, 258 F.2d 577 (5th Cir. 1958) and that of the Ninth Circuit in *Knetsch v. United States*, 272 F.2d 200 (9th Cir. 1959). The Supreme Court denied the interest deduction in a transaction in which the taxpayer made large "interest payments" on an annuity contract and then "borrowed" almost the entire amount by which the loan value of the contract exceeded the "debt" of the taxpayer. Such "borrowings" were somewhat less in amount than the "interest payments." Presumably this difference was to be recouped through tax savings resulting from "interest deductions" and other tax intricacies. The Court considered the transaction a "sham." Mr. Justice Brennan, speaking for the majority, said, "For it is patent that there was nothing of substance to be realized by Knetsch from this transaction beyond a tax deduction." (366) Does this mean that something of "substance" must be realized before a deduction for interest is allowable? Or does this mean only that the realization of something of "substance" must have been a substantial motive of the transaction? What is something of "substance"? Mr. Justice Douglas in dissenting distinguished the transaction before the Court from one which was merely "hocus-pocus." What is mere "hocus-pocus"? Is it distinguishable from a fraudulent return? Mr. Justice Douglas also pointed out that the transaction was not a "sham" in respect to the issuer of the annuity contract. His profit was taxable. Does this mean that there is a notion of "divisible sham" in the tax law?

⁵⁴ Perhaps a lesser cost will suffice in some instances, but the outlook is inflationary. See *James Realty Co. v. United States*, 280 F.2d 394 (8th Cir. 1960); *Aldon Homes, Inc.*, 33 T.C. 582 (1959). The literature on multiple corporations is growing rapidly. A good recent collection of this literature may be found in footnote 3 in *Strecker, Multiple Corporations*, 2 Corp. Pract. Commentator 1 (1960). For a good summary of the advantages and disadvantages of multiple corporations, including the costs mentioned in the text, see *Driscoll, Incorporating, in Multi-Corporate Form, An Existing Business*, N. Y. U. 16th Tax Inst. 243 (1958).

the benefit and, in keeping with the Marshallian curves illustrating the functional relation between supply and demand, the client tends to maximize his "return" by acquiring benefits up to the point where their cost equals their "return."⁵⁵ The Treasury and the Revenue Service, on the other hand, are in the position of a quite perverse storekeeper; they attempt to set the price of their stock of benefits at a level which will remove none of them from their shelves.⁵⁶ Needless to say their perversity has more often than not been overridden by the more conventional merchandising instincts of their ultimate superiors—the taxpayers themselves acting through Congress.⁵⁷ In addition, a uniform price, generally assumed to constitute proper pricing,⁵⁸ quite often does not deter the high-bracket purchaser for whom the benefit has great utility.

⁵⁵ Reform measures in the multiple corporation area are generally directed toward increasing the cost of the benefits sought. See American Law Institute, *Income Tax Problems of Corporations and Shareholders*, Report of Working Views of a Study by the American Law Institute Staff and American Bar Association Section of Taxation Liaison Committee (1958), wherein it is proposed that a brother-sister group be treated as a unit where there is a certain degree of common stockholder ownership and the operations of the group are conducted in an integrated manner. The cost is, therefore, a diffusion of control and operation in what may be an uneconomic fashion.

⁵⁶ The estate tax illustrates this "perversity" extremely well. The benefit of exclusion of property from the gross estate of the decedent carries a fairly high price. *State Street Trust Co. v. United States*, 263 F.2d 635 (1st Cir. 1959) underscores again the truth that a decedent can obtain this benefit only by divesting himself of any appreciable interest in the property and any significant discretionary power to control its beneficial enjoyment. The price may prove injurious to the interests of the decedent's beneficiaries, but this merely serves to protect further the stock of benefits from future would be purchasers. For example, in *State Street Trust Co.* it was made clear that the decedent should either give up being a co-trustee or suffer the imposition of restraints upon his powers as co-trustee, including his investment powers, which would constitute a "determinable standard" under *Jennings v. Smith*, 161 F.2d 74 (2d Cir. 1947). That the price paid by the decedent often enriches the institutional fiduciary is usually overlooked.

⁵⁷ A fairly dramatic example occurred in the estate tax area. In *Spiegel's Estate v. Com'r*, 335 U.S. 701 (1949), the Court determined that retention of a remote reversionary interest by a decedent in property transferred during life, under terms which made possession and enjoyment by the grantees dependant upon surviving the grantor, would bring the entire property within the gross estate of the decedent. At the same time in *Com'r v. Church*, 335 U.S. 632 (1949), the Court overruled *May v. Heiner*, 281 U.S. 238 (1930), which held that a transfer during life under which the grantor retained a life estate would remove the property from the decedent's gross estate. *May v. Heiner* had been made inapplicable to certain transfers made after March 3, 1931 and June 7, 1932 by action of Congress, but *Com'r v. Church* went behind these dates. Congress responded to the Treasury's victories in *Church* and *Spiegel* by obliterating *Church*, although it took three acts to accomplish this, and removing most of the teeth of *Spiegel*. Int. Rev. Code of 1954, § 2037, reflects the domesticated *Spiegel*.

⁵⁸ A non-uniform price has been proposed for the multiple corporation benefits. See Note, 44 Minn. L. Rev. 485 (1960). The author's idea is to permit the use of multiple corporations only where (1) the separate corporation is to undertake a business

It should be obvious that many examples of this benefit-for-a-price phenomenon exist. One instance in which the price is fairly clearly reflected in the precise language of the Code is the Clifford legislation. Examine section 674. The grantor of a trust can "buy" immunity from taxation on the income therefrom and substantial control of enjoyment of income and corpus by employing certain designated trustees.⁵⁹ A similar price is demanded from a donor making a gift to a minor in a manner which will yield the return of an annual exclusion under the gift tax and elimination from the donor's gross estate for estate tax purposes.⁶⁰

Indeed, I rather think that the "business purpose" doctrine and the "thin incorporation" problem can be meaningfully presented as instances in which at least one aspect of the problem is to determine both the price of the benefit and whether it has been paid. In both, the search tends to be to determine whether enough of the disadvantages of the purported relationship exist to justify the award of the tax advantage to the taxpayer. Thus, in "thin incorporation" cases counsel for the taxpayer marshals the factors which tend to show that the "burden" of debt has in fact been shouldered.⁶¹ In determining

unrelated to that of the existing corporation or group and (2) where the size of the new business is substantial in relation to the size of the business presently being concluded. This view is premised upon the author's conception of the purpose of the corporate surtax exemption and accumulated earnings credit, *viz.*, to encourage the growth and expansion of small business. Thus, the benefits should cost small business less than they do large business. An intriguing exercise would consist of working out the devices which would increase the price of benefits in more or less direct proportion to the increase in gross income of the taxpayer. Or should the increase be progressive?

⁵⁹ Thus, where the grantor is not a trustee and no more than half of such trustees "are related or subordinate parties who are subservient to the wishes of the grantor," a power "to spray" income and corpus among beneficiaries may be given the trustees. Int. Rev. Code of 1954, § 674(c). Where the grantor is a trustee the power to accumulate income or to distribute corpus is much more restricted. Int. Rev. Code of 1954, § 674(b)(5) and (6). The institutional trustee is not harmed by these provisions. See note 56 *supra*.

⁶⁰ Int. Rev. Code of 1954, § 2503(c) permits gifts to minors to qualify for the annual exclusion if the property and income therefrom may be expended for the benefit of the minor before he reaches the age of twenty one and to the extent not so expended will pass to him at that time or to his estate should he die before such time. However, the donor should not be the trustee or custodian of such gifts because his death during the term of the trust or custodianship will result in the gift property being included in his gross estate. See *Lober v. U.S.*, 346 U.S. 335 (1953); Rev. Rul. 57-366, 1957-2 Cum. Bull. 618.

⁶¹ Thus, taxpayers will emphasize, where it is possible to do so, such factors as the form of the "debt" instrument, the reasonableness of the ratio between debt and equity, the lack of proportionality between the advances in question and the admitted risk capital, the willingness of outside investors to supply the funds on substantially the same terms, their expectation of repayment, and the similarity of the use to which the funds were put to uses to which the proceeds of commercial loans are put. From the viewpoint of the taxpayers and their tax counsel the problem is to determine the point at which

whether a transaction serves a "business purpose" the courts tend to question whether commercial disadvantages were assumed by the taxpayer in the transaction which he asserts should yield a tax advantage.⁶²

This examination of the extent of conformity to the rule of good law possessed by our federal tax laws should close by describing several other aspects of this law which very nicely demonstrate our desire to have an admixture of risk and security in our society. We pride ourselves on the existence of risk; but we also seek means to reduce or eliminate it. Correspondingly we possess a tax law which has an adventitious side to its character; but we constantly strive to make its operation more predictable. I doubt seriously if we truly wish to eliminate this accidental quality of the law despite efforts on the part of both the Government and the taxpayers to efface it.

In any event, examples of these tendencies are quite common. Our judicial procedure for the disposition of tax cases could hardly be better designed to assure some chance, even though it be remote, to all litigants, including the Government.⁶³ Our procedure in formulating and enacting tax laws has its capricious aspects.⁶⁴ We have

the "cost" of these factors surpasses the tax advantages of the "debt" characterization. Needless to say, taxpayers often yield to the temptation of asserting that the "cost" has been incurred where that is not in fact the case. Counterfeit money is not unknown in the tax market. For the presently leading case in this area, see *Gilbert v. Com'r.*, 248 F.2d 399 (2d Cir. 1957). The Tax Court's opinion on remand, *Gilbert v. Com'r.*, 17 CCH Tax Ct. Mem. 29 (1958), and the affirmance of this decision in *Com'r. v. Gilbert*, 262 F.2d 512 (2d Cir. 1959) are interesting. See generally Caplin, *The Caloric Count of a Thin Corporation*, N.Y.U. 17th Tax Inst. 771 (1959), 43 Marq. L. Rev. 31 (1959); Bittker, *Thin Capitalization: Some Current Questions*, 34 Taxes 830 (1956).

⁶² Compare note 53 *supra*. *Gregory v. Helvering*, 293 U.S. 465 (1935), the starting point in all discussions of the "business purpose" doctrine, has come to mean many things. See Paul, *Studies in Federal Taxation*, Third Series 125 (1940). The doctrine does not condemn directly tax avoidance motives, but it does teach that these motives will be frustrated unless the taxpayers assume some, if not all, of the burdens inherent in the characterization of their transaction which they wish the tax law to adopt. Judge Learned Hand, in *Gilbert v. Com'r.*, 248 F.2d 399, 412 (2d Cir. 1957), stated that the doctrine "covers only those transactions that do not appreciably change the taxpayer's financial position, either beneficially or detrimentally." I think that the detriments are more important generally than the benefits. While it is true that economic benefits realized by the taxpayer in the transaction in which he also seeks a tax advantage suggest a motivation other than tax avoidance, the wise taxpayer often will place more emphasis upon the economic risks and pitfalls which he assumed in the transaction. Those who market tax shelters are not unaware of this fact.

⁶³ See Miller, *The Courts of Last Resort in Tax Cases*, 40 A.B.A.J. 563 (1954); Pope, *A Court of Tax Appeals: A Call For Re-examination*, 39 A.B.A.J. 275 (1953); Griswold, *The Need for a Court of Tax Appeals*, 57 Harv. L. Rev. 1153 (1944).

⁶⁴ See Strayer, *Fiscal Policy and Politics* (1958); Surrey, *The Congress and the Tax Lobbyist—How Special Tax Provisions Get Enacted*, 70 Harv. L. Rev. 1145 (1957).

created an income tax structure with two rate tables, one for ordinary income and one for capital gains, and left rather vague the criteria for determining the transactions to which each applies.⁶⁵ This encourages efforts to create techniques to realize the advantages of the capital gains rate table, and quite often there is a chance for success.⁶⁶ Our search for security manifests itself in the tax structure by our efforts, growing in scope in recent years, to mark with careful statutory language the arrangements which will, and will not, be taxed under the capital gains rate table. The Internal Revenue Code's Subchapters C and K, introduced in recent years, demonstrate this trend.⁶⁷ Although this trend has been properly criticized⁶⁸ and will be further critically examined shortly, it is in keeping with the understandable and pervasive efforts to minimize the risks of commercial and family transactions.

However, the desire to balance risk and security is most significantly manifested by the major policies which shape the tax law. The income tax shows this particularly well. There are a number of reasons which are often used to justify the separate rate for capital gains.⁶⁹ Probably one of the most persuasive of these, at least to

⁶⁵ The text probably requires no citation of authority even for those readers who do not work in the tax field. It is truly amazing how many complex questions in the Internal Revenue Code arise from, or are influenced by, the capital gain—ordinary income rate differential. For two Supreme Court decisions which occupy commanding heights over the capital gains plain which fairly swarms with issues both great and small, see *Corn Products Refining Co. v. Com'r.*, 350 U.S. 46 (1955); *Com'r. v. P.G. Lake, Inc.*, 356 U.S. 260 (1958). Also see Surrey, *Definitional Problems in Capital Gains Taxation*, 69 Harv. L. Rev. 985 (1956).

⁶⁶ A large portion of the problems involved in the taxation of partnerships and corporations stem from efforts to be taxed at the lower capital gains rates. Form of the transaction plays a substantial role in the success or failure of these efforts. See *Television Industries, Inc. v. Com'r.*, 60-2 USTC ¶ 9795, 284 F.2d 322 (2d Cir. 1960) where the taxpayer argued that the transaction should be taxed as if he had used another form which would have had the same economic effect. In rejecting this argument the court said: "The Commissioner is justified in determining the tax effect of transactions on the basis in which the taxpayers have molded them, (citations omitted), although he may not always be required to do so (citation omitted). It would be quite intolerable to pyramid the existing complexities of tax law by a rule that the tax shall be that resulting from the form of transaction taxpayers have chosen or from any other form they might have chosen, whichever is less. (325).

⁶⁷ Subchapters C and K relate to the taxation of corporations and partnerships respectively. The trend is best illustrated in Int. Rev. Code of 1954, § 341, which attempts to prevent the conversion of income which would be taxed at ordinary rates to the corporation into gain taxed at capital rates to the shareholders by means of "collapsing" the corporation. Similar illustrations may be found in the "collapsible partnership" provisions, the detailed rules governing corporate divisions and the receipt of "boot" in corporate reorganizations, the somewhat uncertain constraints relating to stock redemptions and partial liquidations, and many others.

⁶⁸ Cary, *supra* note 14.

⁶⁹ The best recapitulation of these reasons is in Blum, *A Handy Summary of the*

relatively neutral observers, is the contribution the reduced rate makes to economic growth through encouraging investment and the mobility of capital. Irrespective of whether the same stimulus could not be achieved by reducing the rate of progression sharply, the fact remains that we seek to advance our market and risk-oriented economy by providing some security against its failure. Various micro-economic measures to increase security also exist in the tax law. The aged, the blind,⁷⁰ the sick,⁷¹ and the victims of storm, fire and earthquake⁷² all find some assistance in their hour of need in the income tax. Small business,⁷³ farmers,⁷⁴ insurance companies,⁷⁵ trust companies,⁷⁶

Capital Gains Arguments, 35 *Taxes* 247 (1957). Also see Seltzer, *The Nature and Tax Treatment of Capital Gains and Losses* (1951); Tax Institute, *Capital Gains Taxation*, Panel Discussion (1946).

⁷⁰ Int. Rev. Code of 1954, § 151.

⁷¹ Int. Rev. Code of 1954, § 213.

⁷² Int. Rev. Code of 1954, § 165(c)(3). Like some inscrutable deity the tax law also offers succor to those who suffer loss because of termites which operate as a suddenly invading hostile force but denies its comfort to those whose losses are caused by termites which stealthily infiltrate and gradually destroy their objective. *Rosenberg v. Com'r.*, 198 F.2d 46 (8th Cir. 1952).

⁷³ The surtax exemption available to corporations whose taxable income does not exceed \$25,000 and the accumulated earnings credit of \$100,000 are obvious examples of tax aids to small business. Int. Rev. Code of 1954, §§ 11, 535(c)(2). In 1958 a number of additional aids were added to the Code. *E.g.*, the additional first-year depreciation allowance for small business, § 179; the favorable treatment of losses on Small Business Investment Company and Small Business stock, §§ 1242-44; Subchapter S which permits certain "Small Businesses" to elect a special method of taxation which tends to reduce taxes at the corporate level, §§ 1371-77. The end of such aids is not in sight. See *The Wall Street Journal*, Jan. 4, 1961, Tax Report, p. 1.

⁷⁴ For a good summary of many of the major tax advantages available to farmers, see Boehm, *Tax Accounting For Agriculture* 17 Ohio St. L.J. 1 (1956). One of the most outstanding is the farmer's ability to use a cash basis of accounting even when inventories are significant. This accounting method cuts the other way, however, when inventory prices are declining. Self-help by farmers in under-reporting income items exists and is tolerated by the government. See Kahn, *Coverage of Enterprenurial Income on Federal Tax Returns*, Tax Revision Compendium, House Committee on Ways and Means, 86th Cong., 1st Sess. (1959) Vol. 2, 1439.

⁷⁵ There are numerous ways in which the Code provides tax advantages to those who invest in insurance. These tax advantages bestow upon insurance companies a commercial advantage in competing for investment funds. One of these tax advantages is that the earnings on the savings part of the insurance premiums are seldom taxed. These earnings, which go to build up the cash surrender and loan values of the policies, are received by the beneficiaries of the policies upon the death of the insured without tax. There may be a small tax imposed when the policy is surrendered prior to the death of the insured; but in no event is the full amount of the earnings made subject to tax. See Vickery, *Agenda For Progressive Taxation* 64-70 (1947). The exclusion of insurance proceeds paid by reason of the death of the insured from the gross income of the beneficiary sometimes suggests some rather spectacular tax savings possibilities. See *Ducros v. Com'r.* 272 F.2d 49 (6th Cir. 1959); Note, 45 Cornell L.Q. 818 (1960). There are also estate tax advantages available to the investor in insurance. Int. Rev. Code of 1954, § 2042. Until the Life Insurance Company Act of 1959 the income taxation of insurance companies was quite favorable in that "underwriting" income and capital

mineral producers⁷⁷ and many others⁷⁸ find some protection against economic austerity in this tax. On the other hand, the ideal of the self reliant person able to encounter the uncertainties of his world is promoted by encouraging work on the part of children,⁷⁹ provision for retirement through pension plans,⁸⁰ the relatively early assumption of financial responsibilities by children⁸¹ and the discharge of conjugal responsibilities by adequate provision for the surviving spouse.⁸²

Running through many of these policies is not only a sometimes

gains were not includible in the tax base. Some contend that it remains favorable. Lent, *The Tax Treatment of Life Insurance*, Tax Revision Compendium, House Committee on Ways and Means, 86th Cong., 1st Sess. (1959), Vol. 3, 1995.

⁷⁰ See notes 56 and 59 *supra*.

⁷⁷ Percentage depletion and the deduction for intangible drilling and development costs are too well known to require further comment.

⁷⁸ Those who trade in, or derive a living from, stocks and securities are beneficiaries of the lower rate applicable to capital gains and the dividend received credit and exclusion. Int. Rev. Code of 1954, §§ 34, 116. Employees beset with illness may exclude under certain circumstances a portion of the wages paid by the employer during the period of misfortune. Int. Rev. Code of 1954, § 105(d). The timber and coal industries are entitled to the capital gains rate on a substantial portion of their income. Int. Rev. Code of 1954, §§ 631, 1231. It is indeed a forgotten man who can not find at least a crumb dropped from that bountiful table of tax advantages which is the Internal Revenue Code.

⁷⁹ Earnings of a child are not taxable to the parent, and, in the case of a child under 19 years of age or who is a student, these earnings may exceed \$600 without causing a loss by the parent of his dependency exemption as to the child where over half of the child's support is furnished by the parent. Int. Rev. Code of 1954, §§ 73, 151(e), 152.

⁸⁰ The basic structure of the tax law's encouragement of pension plans is found in its treatment of "qualified retirement plans." The employer's contribution is deductible, the earnings of the fund are exempt, and the covered employees are taxed only upon receipt of the benefits under such retirement plans. "Evidence of the effectiveness of these tax incentives and the impact of any tax provision on the development of employee-benefit plans is the tremendous number of qualified retirement plans of many different types that have been established since 1942. It is currently estimated that well over 50,000 qualified plans with reserves approaching \$40 billion now cover about 18 million employees and indirectly many additional millions of dependents." Seligman, *Pension and Other Employee Benefit Plans*, Tax Revision Compendium, House Committee on Ways and Means, 86th Cong., 1st Sess. (1959), Vol. 2, 1353, 1358. It appears probable that retirement programs for the self employed will receive tax encouragement in the near future.

⁸¹ The income, estate and gift tax advantages of gifts to children with a frequency and regularity surpassing that which would be the case were the motivations only those rooted in parental love and affection are well known. The result—parents in somewhat reduced circumstances watching their offspring "take over the reins" and hoping that what they retained for themselves will "see them through"—may be poor geriatrics, but it does provide for an earlier assumption of responsibility by children than would otherwise be the case. It would be a foolish man who was convinced that the result met the standard of the utilitarians.

⁸² The reference is to the marital deduction in the estate and gift tax. Int. Rev. Code of 1954, §§ 2056, 2523. The estate tax marital deduction fixes the basic pattern of most estate plans. See note 48 *supra*.

offensive display of cunning and greed, but also a praiseworthy effort to refine the ideal of equal taxation of equals. All realize that there are times when equal incomes should not be taxed equally because the surrounding circumstances suggest that to do so will either perpetuate or create inequalities. Bunched income,⁸³ income from the discharge of indebtedness which does little to increase the liquidity of the taxpayer,⁸⁴ gains substantially attributable to inflation where reinvestment is necessary as in the case of residences,⁸⁵ all are instances which force us to recognize that "a dollar is a dollar" view of tax equity is not a perfect measure. Thus, the unattainable ideal of equals taxed equally moves us to seek means to advance the interests of those mangled by the dull edge of the "a dollar is a dollar" sword of equity. By so doing, our purpose is to advance the rule of good law by bringing to more people the sense of being permitted to share in the possession of justice, and in the processes by which it is achieved, and by fostering the sense of belonging and the ability to be an independent individual.

IV

THE EXTENT OF NON-CONFORMITY OF FEDERAL TAXATION TO THE RULE OF GOOD LAW

The recounting of the many ways in which the tax law measures up to the bench mark of the rule of good law may suggest that I am finding "sermons in stones and good in everything." And to some extent I am. This, however, permits me to make a fundamental point of this paper. It is that a substantial portion of the characteristics of the tax law which do not conform to our standard of measure comes about because of our overzealous efforts to attain such conformity. We seek the good but find both good and evil. This is

⁸³ The reference is to income derived from work or transactions extending over a number of taxable periods but received or earned in one such period. Progression often makes the tax greater than it would have been had the income been received ratably over the taxable periods involved. The almost ideal solution would be some overall averaging system. The Code now has only a number of provisions dealing with specific instances of bunched income. Int. Rev. Code of 1954, §§ 1301-07.

⁸⁴ Discharge of indebtedness does not result in taxable income if the debtor remains insolvent after the discharge. *Astoria Marine Construction Co.*, 12 T.C. 798 (1949); Treas. Reg. § 1.61-12(b) (1957). The entire problem of the treatment of income arising from the discharge of indebtedness is a troublesome one which is not comprehensively treated in the Code or regulations. Throughout the material dealing with the problem is the recognition that "equity" often demands more than simply a balance sheet improvement before assessment of a tax is proper. A "spreading device" for income from discharge of an indebtedness is provided in certain instances. Int. Rev. Code of 1954, §§ 108, 1017.

⁸⁵ Int. Rev. Code of 1954, § 1034 provides for non-recognition under certain circumstances.

nothing new in human experience; indeed, it is one aspect of the Book of Job. Perhaps a good act always produces an evil result often times as great, or greater, in magnitude than the good accomplished. Perhaps also an evil act always produces a good result often surpassing the scope of its originator. In any event, in framing the tax law we have tended to ignore the wisdom which extols balance, restraint, and nothing to excess. In so doing we have given insufficient attention to opposing forces in man's nature, assuming that if our cause was right only good could result from our efforts. But there is always a dark column which marches in the army of the righteous. It loots while the light forces liberate.

Let me be specific. Each characteristic mentioned as contributing to the rule of good law is joined with an opposing one which does not. As the pursuit of the former intensifies the scope of the latter increases. As we raise more funds for armaments to maintain the peace necessary for survival and the good life, we grow poorer and more prone to wage war. Progression encourages the wasteful practice of multiplying taxpayers, fictitious and real,⁸⁶ and creates many tax accounting problems.⁸⁷ The illusion by the many respecting the extent of progression borne by the rich prepares the way for a reaction of bitterness when the truth is known. In addition, the present rate structure is maintained, presumably, as a symbol of virtue while most taxpayers by one means or another escape its full impact. Some do not, and the tribute exacted from them is the price of this bit of goodness. Self-assessment penalizes the honest, further erodes honesty by posing moral dilemmas too onerous to be borne by the ordinary person, and permits large sums of income to go untaxed.⁸⁸ With-

⁸⁶ See pp. 224-25 *supra* and note 55 *supra*. In addition to multiple corporations, gifts of property in trust, or otherwise, and family partnerships are obvious techniques for increasing the number of taxpayers. Even more obvious is the joint return device.

⁸⁷ The problem of "when" an item becomes taxable would be much less significant were the rate proportional since it would be subject to a flat rate of tax whenever brought within taxable income. Probably, however, there would still be pressure from the government to collect the tax as early as possible and from the taxpayer to defer such collection. Certainly this would be the case if the present forgiveness at death continued. Int. Rev. Code of 1954, § 1014. Nonetheless, it is likely that without progression some of the anomalies of tax accounting, such as the inclusion in gross income of the entire amount of advance income payments received by an accrual basis taxpayer, could be eliminated. Even without such a sweeping change there is some indication that the particular anomaly mentioned, the prepaid income problem, may be eliminated. See *Beacon Publishing Co. v. Com'r*, 218 F.2d 697 (10th Cir. 1955); *Bressner Radio, Inc. v. Comm'r*, 267 F.2d 520 (2d Cir. 1959).

⁸⁸ It is useful to bear in mind, however, that more income tax is collected through self-assessment than withholding. Kahn, *Compliance and Enforcement Problems*, Tax Revision Compendium, House Committee on Ways and Means, 86th Cong., 1st Sess. (1959), Vol. 2, 1467, 1468. Former Commissioner Harrington recently stated that about

holding partially conceals from the taxpayer the magnitude of the burden he carries and thus reduces his ability to rationally evaluate the merits of proposed expenditures.⁸⁹ Thus, in time the perfervid pursuit of equality, through taxation as well as otherwise, will collide with liberty and overtake mediocrity.

The immanence of non-conformity with the rule of good law in efforts to attain conformity is nowhere better revealed than in the aspects of the tax structure which reflect our desires about the proper balance between the individual and the group. It will be recalled that the taxes are designed for a money and market oriented economy. The imposition of taxes so designed, however, encourages the growth of what the British call perquisites at the expense of wages and salaries⁹⁰ and the development of barter.⁹¹ The rationalism demanded by both our calculating, record-keeping society and our tax system distorts the operation of the market⁹² (as the illustrations I used

24 billion of income was not reported in 1957. Harrington, *Improving Income Tax Reporting*, Id. at 1461. It has been estimated that dividend income and interest income was under-reported 1.2 billion and 3.5 billion, respectively, in 1957. Holland, *Under-Reporting of Dividends and Interest on Tax Returns*, Id. at 1397. There is some indication that there has been some decline in this under-reporting recently.

⁸⁹ Seldom is this unfavorable characteristic of withholding mentioned in the current literature on the subject. Generally administrative difficulties are emphasized in resistance to the extension of withholding. For proposals suggesting a substantial expansion of withholding, see Atkeson, *Improvements In Tax Administration and Compliance*, *Tax Revision Compendium*, House Committee on Ways and Means, 86th Cong., 1st Sess. (1959), Vol. 2, 1499, 1501. The theme implicit in the text is developed fully in the statement of the Roman Catholic Bishops of the United States, November 19, 1960 on the personal responsibility of free men. *N. Y. Times*, Nov. 20, 1960, § 1, p. 74.

⁹⁰ "Yet it is clear also that there is a steady drive by organized labor to have employers increasingly bear the living expenses of their employees. Whatever may have been the arrangements and traditions that existed prior to the income tax, it is evident today that tax considerations play an important, if not major role in the extension of fringe benefits. It is obvious that a mass income tax must squarely face these changing patterns of compensation which it generates. . . ." Surrey, *The Federal Income Tax Base for Individuals*, 58 *Colum. L. Rev.* 815, 824 (1958).

⁹¹ Exchanges of properties of a "like kind" do not result in recognition of gain or loss. *Int. Rev. Code of 1954*, § 1031. This makes sense in a money and market-oriented economy. However, to take advantage of this provision property exchange clubs have sprung up in recent years. See *Wall Street Journal*, Sept. 15, 1960, p. 1, col. 4.

⁹² Such a statement as this should always be read against the fact that practically all tax systems alter the choices which would otherwise be made in a free market. Certainly this is true of the income tax. "Legislators who could devise an income tax system in which preferences are eliminated would enshrine themselves in the minds and hearts of men forever. However, a graduated income tax system by its very nature cannot be solely a revenue raising device without overtones of social and economic engineering." Galvin, *The Deduction For Percentage Depletion and Exploration And Development Costs*, *Tax Revision Compendium*, House Committee on Ways and Means, 86th Cong., 1st Sess. (1959), Vol. 2, 933, 941. Nonetheless, it is possible so to

above should have indicated),⁹³ diverts countless man-hours of thought from other activities which possibly would be more productive,⁹⁴ imposes heavier tax burdens on those not wise enough to obtain (or fortunate enough to get) the best tax advice,⁹⁵ and probably increases the sense of helplessness and of being alone of all who attempt to complete their own returns. The benefit-for-a-price structure, while conforming to our ingrained habits of trade, encourages the quest for bargain-counters and in many cases twists transactions from "normal channels." However, it must be said that as time passes and the pre-income tax days fade from memory the guide line of the "normal transaction"—what the parties would have done in the absence of taxes—becomes quite indistinct.⁹⁶ Perhaps "what the parties would have done under the next preceding Code" will take its place.

Our admixture of risk and security reflected in the tax structure also carries a burden of non-conformity. The capricious side of the law as written and administered certainly violates the canon of equals taxed equally.⁹⁷ The elaborate specificity of the law obviously tends to make the law more capricious by creating a horde of new issues⁹⁸

design the tax structure as to increase or decrease its compatability to a free market. Maximum compatability is not a feature of our present tax system.

⁹³ See pp. 221-23 *supra*.

⁹⁴ We simply do not know the total cost of administering our present income, estate and gift tax. More, much more, investigation of such matters should be undertaken. Naturally this cost includes the maintenance of the vast army of tax advisers, one or more of whose members are detailed to guard and protect every transaction of any substantial economic consequence in American life.

⁹⁵ On what constitutes the "best" tax advice, see Darrell, *Some Responsibilities of the Tax Adviser in Regard to Tax Minimization Devices*, N.Y.U. 8th Tax Inst. 983 (1950) and the sequel, *Conscience And Propriety In Tax Practice*, N.Y.U. 17th Tax Inst. 1 (1959).

⁹⁶ For example, is the manner of financing acquisitions of mineral properties before the evolution of the A B C device (whatever that manner was) the "normal transaction"? Or, what is the "normal" way to go about merging corporations? The techniques which existed prior to 1913?

⁹⁷ On the capriciousness inherent in giving the triers of fact large discretion in determining whether a tax law characterization, such as "gift," is applicable to a specific fact situation, see Griswold, *The Supreme Court, 1959 Term, Foreword: Of Time and Attitudes*—Professor Hart and Judge Arnold, 74 Harv. L. Rev. 81, 88-91 (1960).

⁹⁸ See Cary, *supra* note 14. Professor Brown has recently addressed himself to this problem and the pith of his remarks can be conveyed by the following extract: "I have said that the stated purpose of elaborate statutory formulation is to produce certainty and predictability. One may say with some assurance that this purpose has scarcely been achieved. To take a few examples, one may say that §§ 302 (with 318), 306, 341, 346, 354, and 355 (with 368), 381 and 382 have added little, if anything, to pre-existing certainty, while each has brought with it a steadily increasing progeny of new uncertainties. But I believe the purpose of the current type of formulation springs from related but deeper roots. Fundamentally, it appears to spring from an attempt to eliminate,

which, if they do not completely bewilder the taxpayer and the government employees, will introduce additional "trading bait" in settlements and compromises. In addition, their presence slows analysis of tax issues and thus adds to the burden of administering the taxes.

Most important, however, is that the policies we employ to further the virtues of individuals and the economic growth and stability of our business enterprises, while in one sense attaining their ends, to some degree increase dependence upon the existing tax law. People and money move in the channels cut by the tax law. Lives and fortunes become committed to structures supported by a few words in the Code. Depletion and capital gains are cases in point.⁹⁹ When the precariousness of this support is realized there is good reason to feel adrift and severed from reality. "To each according to the will of Congress" is not always preferable to "To each according to the free market," or "To each according to custom."

Estrangement from reality is further enhanced by the fact that as we employ in the tax law an increasing number of devices to promote our notions of virtue and the good economic life the consequence of each becomes more uncertain.¹⁰⁰ Each device has its own

so far as possible, the necessity for responsible administration. Experience seems to be demonstrating that this is foredoomed to failure." Brown, *An Approach To Subchapter C, Tax Revision Compendium*, House Committee on Ways and Means, 86th Cong., 1st Sess. (1959), Vol. 3, 1619, 1620.

⁹⁹ Having been privileged to live in Texas and the Northeast, I have noticed what appears to me to be a certain degree of similarity of response by many inhabitants of both regions to suggestions that one of their dominant tax advantages (depletion, of course, in respect to Texans and capital gains to Easterners) be eliminated. I need not describe the nature of the response.

¹⁰⁰ See, Brown, *Purposes and Functions of Depreciation Under the Income Tax*, Tax Institute, *Depreciation and Taxes* (1959) for a discussion of the conflict between monetary policies directed against inflation and liberal depreciation allowances. The substance of the case against too frequent use of the tax law to promote particular social and economic ends recently has been put succinctly by Professor Blum as follows: "However, it is worth underscoring that subsidies through the income tax are likely to be especially pernicious. I merely repeat myself and many others in noting that by nature such subsidies tend to be hidden; their magnitudes are very hard to estimate; *their efficacy is difficult to gage*; no agency is charged with watching over and reporting on them; the recipients are by and large unidentified; *some of their effects usually are unintended*; and they do not appear as expenditures in the Government budget. All in all, a less desirable form of administering a subsidy is not easily imagined. But this is a relatively minor point. By economic standards it is the dimensions of many tax subsidies rather than the shortcomings in the mechanism for administering them which is more significant—and that matter, I trust, has already been put in its proper place." (Italics added.) Blum, *Tax Policy and Preferential Provisions In The Income Tax Base*, *Tax Revision Compendium*, House Committee on Ways and Means, 86th Cong., 1st Sess. (1959), Vol. 1, 77, 83. "Incentive taxation," as tax subsidies have sometimes been called, has been criticized by some of the leading writers in the field of tax policy. See Groves,

built in contradiction and there arises the necessity to work out difficult accommodations between them. The differential rate on capital gains and accelerated depreciation, for example, are both designed, at least in part, to promote economic growth. Both, as noted, draw the economy closer to dependence upon tax policy, partially frustrate the purpose of progression, and generate the necessity of accommodation between themselves. This necessity is clearly discernible when the taxpayer disposes of a section 1231 asset,¹⁰¹ after depreciation at a rapid rate, for a price in excess of its adjusted basis.¹⁰² The gain, taxable at capital gains rates under section 1231, represents business earnings, the tax on which was not only deferred but is assessed at a rate lower than that which applies to other such earnings.¹⁰³ Accommodation is fairly simple here, although it has not been done as yet, because all that is required is to provide that the gain is taxable as ordinary income.¹⁰⁴ It is not so simple in other areas, however. Capital gains rates and Subchapter S,¹⁰⁵ the provisions of which in a general sense permit a corporation to be taxed somewhat in the manner of a partnership, attempt in quite different fashions to promote a sound economy. The collapsible corporation provisions are designed to curb an abuse of capital gains which consisted of selling or liquidating a corporation after its earning potential was fairly predictable but before such income was realized and having the gain taxed at capital gains rates.¹⁰⁶ This curb is now undercut to some extent by Subchapter S which permits gains on the sale of capital assets by the corporation to be "passed through" to

Postwar Taxation and Economic Progress 14, 303-06 (1946); Vickery, *Agenda For Progressive Taxation* 392 (1947).

¹⁰¹ Int. Rev. Code of 1954, § 1231(b).

¹⁰² The depreciation referred to is that presently allowed under Int. Rev. Code of 1954, § 167. Section 1238 of the Code precludes the application of § 1231 to the gain from the sale or exchange of property subject to the amortization deduction of emergency facilities under § 168.

¹⁰³ See Surrey and Warren, *Federal Income Taxation* 705 (1960 ed.).

¹⁰⁴ *Id.* There is, however, a special sort of irony apparent when one considers the origin of the necessity for "accommodation." Int. Rev. Code of 1954, § 1231, came into the law in 1942 to relieve taxpayers of ordinary income tax rates on gains resulting from involuntary conversions and sales and exchanges prompted by the circumstances of the war effort. It has remained, however, as a permanent part of our capital gains structure. For a good description of the history of § 1231 see, Bittker, *Federal Income, Estate and Gift Taxation* 403-06 (1958).

¹⁰⁵ See note 73 *supra*.

¹⁰⁶ Int. Rev. Code of 1954, § 341. These provisions in a somewhat less complex form first made their appearance in the law in 1950. The curb is to make the gain on sale or liquidation taxable as ordinary income. However, the curb may be avoided by having the corporation realize a substantial portion of the income before the sale or liquidation. *E.g.*, Kelley, 32 T.C. 135 (1959).

the shareholders and there taxed at capital gains rates.¹⁰⁷ Where these assets have a fairly predictable earning power the necessity for accommodation between Subchapter S and the paraphernalia of capital gains becomes obvious.¹⁰⁸ And so it goes. As the devices multiply, additional correctives are spawned which, in turn, require further adjustments which, in their turn, make necessary adjustments to adjustments. In due course the effectiveness of any measure which is designed to promote fairly specific social, economic and political objectives becomes more difficult to ascertain. Slowly the waters of futility and bewilderment rise until they lap at the citadel of reason.

Finally, in many respects the most frustrating of our efforts is that by which we seek to refine the ideal of equal taxation of equals. The task is never ending and, in time, will create statutory monstrosities. Not only is this true because of the difficulty in technically working out the means of achieving our ideal,¹⁰⁹ but also because circumstances and our notions of equality change. While it is true that "a dollar is a dollar" notion of equity is far from perfect, it does possess the virtue of simplicity. Refinements of the ideal unavoidably draw upon our views of distributive justice and these change. Consider depletion again. Discovery value depletion, the forerunner of percentage depletion, was introduced to accomplish, *inter alia*, the elimination of the necessity of sale of oil discoveries by their finders to others.¹¹⁰ In one sense, this was to provide equal taxation of equals, but also it reflected a judgment about the proper ordering of our economic life, and, thus, distributive justice. Certainly similar considerations prompt both proponents and opponents of the present depletion structure. These changes in our notions of distributive justice give us new insights into the meaning of equality for the purpose of imposing equal tax burdens. One more example which should be approvingly received by my academic readers is this. Can it not be said that the increasing ability of the service to discern the ideal

¹⁰⁷ See Caplin, Subchapter S—Election of Small Business Corporations, Tax Revision Compendium, House Committee on Ways and Means, 86th Cong., 1st Sess. (1959), Vol. 3, 1711, 1715.

¹⁰⁸ An attempt to do so is made in Treas. Reg. § 1.1375-1(d) (1959).

¹⁰⁹ A home owner who sells his residence at a gain attributable to inflation and purchases another at the same price at which the former was sold has a strong claim for avoidance of tax on the gain. He can say, with considerable force, that his gain does not make him equal to one who sold securities at a gain. In any event, the Code has accepted his argument. Int. Rev. Code of 1954, § 1034. However, to work out the details required ten subsections, (a) through (j), many of which contain subsections, and all of which contain more than fifty words.

¹¹⁰ See Sneed, The Economic Interest—An Expanding Concept, 35 Tex. L. Rev. 307, 314 (1957).

of which we speak in the issue of deducting educational expenses¹¹¹ is partly due to the somewhat greater recognition and acceptance since Sputnik of the view that the educator's share of our wealth should be increased? The arguments over tax law are not bottomed simply on "whose ox is being gored," but much also turns on the issue whether "what is being gored is an ox."

V

MEASUREMENT AND SUGGESTIONS

Notwithstanding these growing defects in our tax law, it is, on balance, in substantial conformity to the rule of good law. Of this fact we can be proud. It cannot be made perfect because, to paraphrase Lincoln, it is of, for, and by the people. It accomplishes reasonably well the three purposes served by the rule of good law. Its defects are those which demand understanding and compassion, traits not particularly prominent in the American character, because although many spring from greed (a characteristic which also works in favor of a good tax law) most are rooted in a zeal to do good work.

Were I the lawgiver, a thought which causes as many shudders in me as, I am sure, it does in those readers who have reached this point in a state of mild frenzy induced by repeated inner shouts of "NO! NO!," there would be a number of changes in the law. Most of these, shaped largely by the writings of Simons, were presented in skeletal form some time ago to a Congressional Committee¹¹² which listened with more deference than I deserved, but whose sophisticated air led me to realize that I was as far removed from the world of practical tax politics as in my heart I had suspected I was.

So chastened, there will be no ticking off of twenty or more specifics which must be adhered to if doom is to be avoided. Instead this venture into jurisprudential taxation will close by suggesting only two fairly concrete guides to be used in formulating tax policy. The discussion to this point has foreshadowed them. The first is to depart infrequently from the "a dollar is a dollar" concept of tax equity. The second, which is largely implicit in the first, is to pursue in the tax law only a limited number of social, economic and political objectives and to restrict these to those about which there is a wide consensus. It may be thought that both are inconsistent with the variety which has been shown to be in keeping with the purposes of

¹¹¹ The reference is to Treas. Reg. § 1.162-5 (1958) which increased substantially the scope of educational expenses which the Commissioner is willing to consider as ordinary and necessary expenses in carrying on a trade or business.

¹¹² Major Objectives of and Guides for Income Tax Reform, Tax Revision Compendium, House Committee on Ways and Means, 86th Cong., 1st Sess. (1959), Vol. 1, 61.

the rule of good law. A rigid inflexible adherence to "a dollar is a dollar" equity and a narrow, all consuming, pursuit of one objective (reduced inequality, for example) would be. What is being suggested is simply the avoidance of the other extreme—the frenzied and uncritical effort to attain a vast multitude of social, economic and political objectives. Such an effort is self defeating. The accomplishments of progression, as modest as they are, will be further jeopardized. The objectives which rest on a wide consensus will be frustrated by unexpected contradictions created by efforts to attain ends which enjoy lesser support, and the extent to which any are achieved will become quite obscure. The avoidance of near chaos and the achievement of any fairly concrete end depend upon the moderate pursuit of a relatively few social, political and economic objectives.

Obviously my suggestions come down to saying only that we should pursue neither too few nor too many objectives in our tax law. This is a commonplace, but one which we may be about to forget. Perhaps I am again being naive to suppose that my suggestions will be heeded, but their practicality depends on nothing more than their acceptance. Perhaps I have no right to expect this, but my conscience and my profession make it my responsibility to suggest it.